DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**08/08/00**	Bill No:	**AB 2894**
Tax:	**Sales and Use Special Taxes**	Author:	**Assembly Revenue and Taxation Committee**
Board Position:	**Board-sponsored – Support**	Related Bills:	**SB 2174 (Chesbro, et al.) SB 2175 (Chesbro, et al.)**

BILL SUMMARY:

This bill contains Board of Equalization-sponsored proposals that would accomplish the following:

1. Allow a purchaser to issue an exemption certificate to a fuel vendor for an amount equal to the sales or use tax on the federal manufacturers' or importers' excise tax imposed on his or her qualifying and nonqualifying fuel purchases under specified circumstances *(§§ 1,1.3, and 1.6).*

2. Authorize the Board to prescribe a method to authenticate electronic returns and applications filed with the Board *(§§ 1.4, 4 and 5)*.

3. Make technical changes to conflicting laws providing a sales and use tax exemption for the sale or lease of aircraft by air common carriers *(§§ 2 and 3)*.

4. Eliminate the requirement that settlement disputes totaling less than $5,000 for Sales and Use Tax administered by the Board be presented to the Attorney General for review. This bill would delegate this authority jointly to the Board's Executive Director and Chief Counsel *(§ 6)*.

5. Add the requirement for persons whose estimated tax liability averages $20,000 or more per month to submit payment by electronic funds transfer (EFT) for certain Special Taxes accounts *(§§ 7-14, 16-19, 21-27, 29-32, 34-37, 39-45, 47-50, 52, 54-58, 60-63, 65, 67-69, 71 and 73-76)*.

6. Delete a typographical error in legislation added in 1999 *(§§ 51, 64 and 70)*.

SUMMARY OF AMENDMENTS:

Provisions were removed from the bill which would have eliminated the requirement that Special Taxes settlement disputes totaling less than $5,000 be presented to the Attorney General for review.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

ANALYSIS:

Sections 1, 1.3 and 1.6

Current Law:

Under existing law, the amount of any federal manufacturers' or importers' excise tax imposed pursuant to specified provisions of the Internal Revenue Code for which the purchaser certifies that he or she is entitled to either a direct refund or credit against his or her income tax for the federal excise tax paid is excludable from the measure of sales and use tax. The certificate can be issued only when purchasing qualifying fuel, that is, fuel for which the purchaser expects to use in a manner exempt from the federal excise tax. Thus, when a purchaser purchases fuel in bulk, the use of some of which will qualify for the exemption but not all, the purchaser may not issue an exemption certificate and will be required, instead, to pay sales tax reimbursement or use tax on the entire purchase. This will include payment of tax or tax reimbursement on federal excise tax for which the purchaser will later obtain a refund from the Internal Revenue Service (IRS). A claim for refund of the overpaid sales or use tax on the amount of the federal excise tax may thus be filed. The claim for refund must be supported by proof of the exempt use of the fuel (as for example, off-road use) and of the refund or credit of the federal excise tax by the IRS to the purchaser. When the applicable tax was sales tax, it is the vendor who must file the claim for refund, and then refund the amount of the excess sales tax reimbursement collected from the purchaser upon refund of the overpaid sales tax to the vendor.

Proposed Law:

This bill would enable the purchaser to issue an exemption certificate to the fuel vendor for an amount equal to the sales or use tax on the federal manufacturers' or importers' excise tax imposed on his or her entire fuel purchase when purchasing both qualifying and nonqualifying fuel if at least 50 percent of his or her fuel purchase qualifies for the exemption from federal excise tax. This bill would require that the purchaser have a seller's permit and also require that the purchaser self report any tax due for fuel purchased under an exemption certificate.

Comments:

Several construction and utility companies who purchase qualifying and nonqualifying fuel in bulk purchases have expressed concern over the long process currently required to receive credit for the sales tax reimbursement remitted to their fuel vendors on their purchases of fuel qualifying for an exemption from the federal manufacturers' or importers' excise tax. The process is especially long, since, in order for a refund to be processed by the Board, the purchaser must first file for a refund or credit for the excise tax paid with the IRS and obtain the refund or credit. When the original sale was subject to sales tax, the purchaser must then show proof to his or her vendor of the credit or refund obtained, and then request the vendor to file a claim for refund with the Board. The vendor, in turn, is then actually required to file the claim for refund with the Board on behalf of the purchaser, provide proof to the Board that the purchaser obtained a credit or refund from the IRS, and provide proof that the fuel was used in an

exempt manner. This can take a period of several months from the time the purchaser remitted the tax reimbursement to his or her vendor until the time the Board initiates a refund. Fuel purchasers have also indicated that it is difficult to issue an exemption certificate to the fuel vendor for only the qualifying portion of the fuel purchase. This bill would eliminate the need for many fuel purchasers to go through the long refund process and would instead simply allow the qualified purchaser to purchase the fuel without payment of the sales or use taxes on the federal excise taxes included in the price of the fuel purchased.

Sections 1.4, 4 and 5

Current Law:

Under existing law, every person desiring to engage in or conduct business as a seller within this state shall file an application for a permit for each place of business. Current law also requires that, in addition to including various information about the seller, the application must be *signed* by the owner, partner or executive officer.

For purposes of the sales tax, a return shall be filed by every seller and also by every person who is liable for the sales tax. For purposes of the use tax, a return shall be filed by every retailer engaged in business in this state and by every person purchasing tangible personal property, the storage, use, or other consumption of which is subject to the use tax, who has not paid the use tax to a retailer required to collect the tax. Returns are required to be *signed* by the person required to file the return or by his or her duly authorized agent. Additionally, if a return is prepared by a paid preparer, that preparer is required to enter his or her name, social security number or federal employee identification number, and business name and address on the return. Any paid preparer who fails to provide the required information shall be subject to a fifty dollar ($50) fine for each failure to provide the required information.

Effective January 1, 2000, as a result of Board-sponsored legislation (SB 1302, Ch. 865, Stats. 1999), the Board is authorized to accept sales and use tax returns by electronic media. Any return filed by use of electronic media is not considered complete, and therefore, not considered filed, unless an electronic filing declaration is *signed* by the taxpayer.

Proposed Law:

This bill would:

- Remove the specific signature requirement for applications for a permit and allow the Board to prescribe the method of authenticating applications filed with the Board.
- Provide that sales and use tax returns filed electronically with the Board be authenticated in a manner prescribed by the Board rather than requiring the taxpayer to sign an electronic filing declaration.
- Remove the requirement that paid preparers provide information about themselves on the return and eliminate the fifty dollar ($50) penalty for failure to include such information.

Comments:

When a document, such as a permit application or tax return, is filed electronically rather than in a hard copy form, the issue of the required signature must be addressed. A signature is an authentication device, ordinarily a person's name written by himself or herself. Current law implies that this form of authentication is required on documents filed with the Board.

By allowing taxpayers to be authenticated by other means, rather than by a traditional signature, the Board will be better equipped to handle the acceptance of documents filed electronically. This will afford taxpayers and the Board the opportunity to take advantage of the many benefits of electronic filing, such as reduced processing costs for the Board and added convenience for taxpayers.

Allowing taxpayers to fill out an application for a permit and submit it electronically could simplify the application process for taxpayers. The simplified application process will benefit taxpayers by allowing them the opportunity to take advantage of new technologies. Additionally, simplifying the application process could potentially reduce incidents of retailers operating without the necessary permit.

In regards to the paid preparer issue, when a paid tax preparer is hired to prepare a tax return for a client, the paid tax preparer is required to furnish information identifying themselves. Paid preparers of sales and use tax returns have expressed concerns that this disclosure of their social security number or federal employer identification number exposes them to risk of credit card fraud or bank fraud. For example, if a taxpayer hires a paid tax preparer and pays for services with a check, the paid tax preparer will generally deposit the check into their own account. When the check is deposited, the account number the check is deposited into is marked on the check for processing. When the taxpayer receives their cancelled checks with their bank statement, the taxpayer will have access to the paid tax preparer's bank account number since it is now printed on their cancelled check. This information, accompanied by the paid tax preparer's social security number or federal employer identification number, is enough information to attempt a fraudulent transfer of funds from the bank or to apply for credit in the paid preparer's name. Further, though a paid tax preparer who fails to provide this information is subject to a fifty dollar ($50) fine, the Board has never imposed this fine on a paid tax preparer since this requirement was added to the statute. These specific provisions are no longer necessary for the proper administration of the Sales and Use Tax Law.

Sections 2 and 3

Current Law:

Current law provides an exemption for sales or leases of aircraft to common carriers, foreign governments, and nonresidents, provided certain requirements are met. Generally, Section 6366 provides the exemption for *sales* of aircraft. The exemption for *leases* of aircraft is generally provided by Section 6366.1.

To qualify for the exemption when an aircraft is sold or leased to a common carrier, certain gross receipt requirements must be met. Section 6366(b) provides a rebuttable presumption that for aircraft *sold* on or after January 1, 1997, a person is not engaged in business as a common carrier if the person's yearly gross receipts from the use of the aircraft as a common carrier does not exceed 20 percent of the purchase cost of the aircraft to him or her, or fifty thousand dollars ($50,000), whichever is less. Section 6366(c) provides the same rebuttable presumption for aircraft *leased* to common carriers, or sold for the purpose of *leasing* to common carriers.

Senate Bill 38 (Ch. 954 Stats. 1996) amended Section 6366(b) to raise the gross receipt requirements for sales of aircraft to common carriers from 10%/$25,000 to the current 20%/$50,000. Senate Bill 38 also added subdivision (c) to Section 6366 to provide the gross receipt requirements for leases of aircraft to common carriers to be 20%/$50,000. However, Section 6366.1(c) also currently provides that the gross receipt requirement for leases of aircraft to common carriers to be 10%/$25,000.

Senate Bill 38 was intended to increase the rebuttable presumption for both sales and leases of aircraft used for common carrier purposes and also to add a "gross receipt" definition. However, the bill incorrectly added the provision regarding *leasing* to Section 6366(c), rather than amending Section 6366.1(c). Therefore, Section 6366(c) and Section 6366.1(c) apply to the same transactions, but are inconsistent with each other.

Proposed Law:

This bill would amend Sections 6366 and 6366.1 to delete the exemption provided for leases from Section 6366 and correctly add it to Section 6366.1.

Comments:

Currently, Section 6366(c) and Section 6366.1(c) apply to the same transactions, but are inconsistent with each other. This inconsistency creates confusion. A person seeking an exemption may mistakenly rely on the presumption level provided by Section 6366.1(c) and overlook the proper presumption level provided by Section 6366(c). This amendment would help clarify the law as it applies to sales and leases of aircraft to common carriers, as was intended by Senate Bill 38.

Section 6

Current Law:

Existing law permits the Board of Equalization and the Franchise Tax Board to "settle" tax disputes without recourse to litigation. This process is intended to avoid the costs and the uncertainty of future litigation for both the state and the taxpayer. Under the settlement process, the BOE and the FTB staff can negotiate a settlement with a taxpayer. In general, the negotiated settlement is reviewed by the Attorney General, who must advise the agency within 30 days whether the proposed settlement is reasonable from an overall perspective. The actual Board of Equalization or Franchise Tax Board then has 45 days in which to act. If no action is taken to reject the proposed settlement, the settlement is deemed to be approved. The entire process is confidential and there is no limit on the amount of disputed tax liability that can be settled.

However, for settlements involving a reduction of $500 or more in tax, a public record is required to be filed in the office of the executive directors of the respective agencies showing 1) the names of the parties, 2) the amount involved, 3) the amount settled upon, 4) the reasons why the settlement is in the best interests of the state, and 5) the Attorney General's conclusion as to whether the settlement is reasonable. At no time in the settlement process may the members of the BOE or the FTB participate, other than to approve or reject the proposed settlement.

Proposed Law:

This bill would eliminate the requirement that settlement disputes involving a reduction in tax and penalties of $5,000 or less for sales and use tax administered by the Board be presented to the Attorney General for review. Instead, this bill would delegate this authority jointly to the Board's Executive Director and Chief Counsel.

Comments:

This settlement authority was originally authorized by Assembly Bill 3225, effective September 15, 1992, and was extended indefinitely by Assembly Bill 3308, effective July 7, 1994. With the enactment of AB 3308, the Executive Officer and Chief Counsel of the *Franchise Tax Board* were provided with the authority to jointly approve settlement disputes involving a reduction in tax and penalties of $5,000 or less without the approval or review by the Attorney General. However, this measure did not grant similar approval authority to the settlement program under the tax and fee programs administered by the Board of Equalization. The Board of Equalization sponsored legislation (Senate Bill 1302) during the 1999 legislative session that would have granted the board settlement authority similar to the settlement authority afforded the Franchise Tax Board. However, Senate Bill 1302 (Chesbro, et al.) was amended to exclude the settlement provisions sought by the Board. Therefore, under existing law, settlement disputes involving a reduction in tax and penalties of $5,000 or less for income or bank and corporation tax matters administered by the Franchise Tax Board can be approved without the Attorney General's review, while all settlement disputes for sales and use tax matters administered by the Board of Equalization require the Attorney General's review.

The purpose of this bill is to streamline the Board's settlement program for smaller cases. Approximately 40 percent of all settled cases are under the $5,000 or less threshold. If this proposal were to become law, staff could settle these smaller cases more quickly and efficiently – taxpayers could have their cases resolved approximately 6 weeks sooner. In addition, staff time currently devoted to preparing the detailed recommendations to be reviewed by the Attorney General on these smaller cases could be more productively spent in processing the more significant settlement cases.

Sections 7 - 14, 16 - 19, 21 - 27, 29 - 32, 34 - 37, 39 - 45, 47 - 50, 52, 54 - 58, 60 - 63, 65, 67 - 69, 71 and 73 – 76

Current Law:

Under current Sales and Use Tax Law, the Revenue and Taxation Code requires any person whose estimated sales and use tax liability averages $20,000 or more per month to remit amounts due by an electronic funds transfer (EFT). In addition, any person may pay by electronic funds transfer, even if the estimated tax liability averages less than $20,000 per month. Under the law, if a person fails to timely remit those taxes, or fails to remit those taxes by an electronic funds transfer, or fails to file a timely return, that person becomes liable for a 10 percent penalty for the amount of those taxes. The maximum penalty that can be applied in any one reporting period is 10 percent (rather than three separate 10 percent penalties for paying late, for filing the return late and for remitting taxes by other than electronic funds transfer).

Under existing law, there are no provisions requiring mandatory payment of taxes or fees by EFT in any Special Taxes Department tax program where the Board collects the tax or fee.

Proposed Law:

This bill would add provisions requiring persons whose estimated tax liability averages $20,000 or more per month to submit payment by EFT for the following Special Taxes programs:

- Motor Vehicle Fuel License Tax
- Use Fuel Tax
- Cigarette and Tobacco Products Tax
- Alcoholic Beverage Tax
- Energy Resources Surcharge
- Emergency Telephone Users Surcharge
- Hazardous Substances Tax
- Integrated Waste Management Fee
- Oil Spill Response, Prevention and Administration Fee
- Underground Storage Tank Maintenance Fee
- Diesel Fuel Tax

This bill would also make conforming changes to the Fee Collection Procedures Law.

In addition, this bill would provide equity between traditional filers and EFT filers by extending the 10 percent penalty for failure to file a return, which is contained in the EFT provisions, to traditional filers.

Comments:

This bill would simply extend the EFT provisions from the Sales and Use Tax Law to certain Special Taxes programs. Extending these provisions would provide tax and fee payers with an additional customer service by offering an alternative payment method. Board staff has determined that 69 percent of the tax or fee payers that would be required to remit payments by EFT under this bill currently remit their sales and use tax payments by EFT. Additionally, 95 percent of the revenue expected to be paid by EFT from Special Taxes program accounts would be from taxpayers already paying their sales and use tax by EFT.

This bill would also eliminate the "float" period (float is the elapsed time between the taxpayer mailing a check and the check being deposited into the Board's bank account) and the State of California would earn additional interest on tax payments deposited. The handling of check payments has inherent delays of processing and clearing time, or "float", caused by the mail. This bill would eliminate a number of methods currently used by taxpayers to maximize the amount of float on disbursements. For example, envelopes can be pre-postmarked or mailed from remote sites. Checks can be drawn against remotely located banks or those which receive only a limited number of checks presented for payment each day. Consequently, a tax payment can be postmarked on the tax due date, but the payment may not be received and deposited by the State Treasurer for a week or more.

Furthermore, this bill would reduce the manual processing of checks.

And lastly, this bill would extend the 10 percent penalty for failure to file a return for traditional filers from the Sales and Use Tax Law to the Special Taxes programs. Senate Bill 1827 (Ch. 1087, Stats. 1996) added this additional penalty to the Sales and Use Tax Law in order to obtain equity between the traditional filers and the EFT filers.

Sections 51, 64 and 70

Current Law:

Under existing law, Sections 45156.5, 50112.4 and 55046 provide the Board with the statutory authority to relieve interest in cases where the reason for the late payment of tax is due to an unreasonable error or delay caused by a Board employee.

Proposed Law:

This bill would correct a typographical error to clarify the Board's authority to relieve interest where the failure to pay tax is due to an unreasonable error or delay by the Board.

Comments:

The Board of Equalization sponsored legislation in 1999 to strengthen and update the California Taxpayers' Bill of Rights. This legislation (Assembly Bill 1638, Assembly Revenue and Taxation Committee, Ch. 929, Stats. 1999) included provisions in the Special Taxes programs which authorized the Board to relieve interest where the failure to pay tax is due to an unreasonable error or delay by the Board.

For the most part, the language in the bill was identical to the language originally drafted by the Board. However, it appears that an "or" was mistakenly inserted in three separate sections of the bill which authorize the Board to relieve interest in cases where the reason for the late payment of tax is due to an unreasonable error or delay caused by a Board employee. The error was amended into Sections 45156.5, 50112.4 and 55046 of the Revenue and Taxation Code which affect the Integrated Waste Management Fee, Underground Storage Tank Fee, and Fee Collection Procedures Law, respectively. This additional word changes the intended meaning of the sections in which it appears. This proposal would simply remove the stray language.

COST ESTIMATE:

Sections 1, 1.3 and 1.6

Minor cost savings due to a reduced number of refund claims filed would be offset by other costs incurred in notifying taxpayers and answering inquiries.

Sections 1.4, 4 and 5

Some costs would be incurred in notifying taxpayers, revising returns and applications, answering inquiries and writing appropriate regulations. These costs are expected to be absorbable.

Sections 2 and 3

Some costs would be incurred in answering inquiries and writing appropriate regulations. These costs are expected to be absorbable.

Section 6

Some cost savings should be realized due to reduced processing costs incurred by Board staff in preparing reports for the Attorney General in settlement cases less than $5,000. Cost savings for settlement cases would be offset by increased costs related to processing a greater number of settlement cases.

Sections 7 - 14, 16 - 19, 21 - 27, 29 - 32, 34 - 37, 39 - 45, 47 - 50, 52, 54 - 58, 60 - 63, 65, 67 - 69, 71 and 73 - 76

The one-time administrative costs associated with this bill would include bank fees, computer programming, and printing explanatory materials. The Board would incur some on-going personnel costs related to establishing and maintaining the new process; however, it is anticipated that these costs would be absorbable. It is also anticipated that there would be a small offsetting savings in personnel costs resulting from a reduction in the manual processing of checks.

Sections 51, 64 and 70

Removing the stray language inadvertently inserted in three separate sections of the Revenue and Taxation Code would not result in additional administrative costs for the Board.

REVENUE ESTIMATE:

Sections 1, 1.3 and 1.6

No revenue impact.

Sections 1.4, 4 and 5

By allowing taxpayers to apply for permits electronically, there is potential for increased compliance from taxpayers who may not have otherwise obtained the necessary permit. However, the Board does not have any data that could be used to quantify the potential additional revenue the state may receive as a result of these provisions.

Sections 2 and 3

No revenue impact.

Section 6

The settlement provisions should result in the collection of tax dollars that could otherwise go uncollected.

Sections 7 - 14, 16 - 19, 21 - 27, 29 - 32, 34 - 37, 39 - 45, 47 - 50, 52, 54 - 58, 60 - 63, 65, 67 - 69, 71 and 73 - 76

Background, Methodology, and Assumptions

During the 1997-98 fiscal year, the Special Taxes Department collected revenues amounting to $5.4 billion from about 165,000 taxpayers. An analysis of the returns filed by these taxpayers indicates that 211 accounts have an estimated tax liability averaging $20,000 per month or more. These taxpayers account for 57.4% of the total revenue collected by the Special Taxes Department.

Requiring these taxpayers to pay by EFT would result in the Board depositing payments approximately three days earlier than under the current system. It is estimated that the annual revenue remitted by those taxpayers that have an estimated tax liability averaging $20,000 per month or more amounts to $3.1 billion. Based on the current interest rate for the Pooled Money Investment Fund of 5.236%, the increased interest that the state would receive on deposited payments would amount to $1.3 million annually. ($3.1 billion x 3 days x 5.236%/365 = $1.3 million.)

Revenue Summary

The increased interest that the state would receive from requiring those taxpayers with an estimated tax liability averaging $20,000 per month or more to make payments via EFT would amount to $1.3 million annually.

Sections 51, 64 and 70

No revenue impact.

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